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In the Supreme Court of the United States

OCTOBER TERM, 1965

No. 735

GAMBLE-SKOGMO, INC.,

Petitioner

vs.

WESTERN AUTO SUPPLY COMPANY AND BENEFICIAL FINANCE CO.

PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE EIGHTH CIRCUIT

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INDEX

	PAGE
Opinions below	1
Jurisdiction	2
Questions presented	2
Statute involved	3
Statement	4
Reasons for granting the writ	8
Conclusion	18
Appendix A—Opinion below	A-1
Appendix B—Judgment below	A-20
Appendix C—Order denying petition for rehearing	A-22

AUTHORITIES CITED

Cases:

Adler v. Klawans, 267 F. 2d 840 ..... 15, 16, 18
Blau v. Lamb (S.D.N.Y. May 1965), 292 F. Supp. 151 ..... 12, 17
Blau v. Lehman, 286 F. 2d 786 ..... 12, 18
Blau v. Lehman, 368 U. S. 403 ..... 9, 11, 13, 14
Blau v. Max Factor & Co., 342 F. 2d 304 (1965) . 12
Ferraiolo v. Newman, 259 F. 2d 342 12
Marquette Cement Mfg. Co. v. Andreas (S.D.N.Y. 1965), 239 F. Supp. 962 17
Smolowe v. Delendo Corp., 136 F. 2d 231 10
United Gas Improvement Co. v. Continental Oil Co., 85 S. Ct. 1517 10

Statutes:

Securities Exchange Act of 1934, 15 U.S.C.A. 78 p(b) 2, 3
Securities Exchange Act of 1934, 15 U.S.C.A. 78 aa 7

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Gamble-Skogmo, Inc., your petitioner, prays that a writ of certiorari issue to review the judgment of the United States Court of Appeals for the Eighth Circuit, entered on July 19, 1965, in the above entitled case.

OPINIONS BELOW

The opinion of the court below (Appendix A, p. A-1) is reported at 348 F. 2d 736. The opinion has also been reported in CCH Federal Securities Reporter Current Decisions. The opinion of the District Court (R. p. 164) on the merits is reported at 231 F. Supp. 456.

JURISDICTION

The judgment of the court below (Appendix B, p. A-20) was entered on July 19, 1965. A timely petition for rehearing was denied on August 13, 1965 (Appendix C, p. A-22). The jurisdiction of this Court is involved under *28 U.S.C.* Section 1254 (1).

QUESTIONS PRESENTED

The questions presented, on substantially all of which the Court below, after eight months of consideration, reversing the District Court divided two to one, all involve the proper interpretation of Section 16(b) of the Securities Exchange Act of 1934, *15 U.S.C.A.* 78 p(b). They are:

1. Whether petitioner's act of acquiring for transfer 32,000 shares of stock of Western Auto of Missouri and immediately transferring 25,942 shares at its cost of $32.-35 per share to meet its obligations to a Profit Sharing Trust can be deemed a "purchase" under 16(b) and made the basis for later penalties.

2. Later, as a result of an antitrust suit, petitioner sold its entire stock holdings in Western Auto of Missouri, including 6,058 shares not transferred to the Trust Fund, at $36 per share. The question is whether this sale can be deemed a "sale" under 16(b) and made the basis for later penalties so far as any part of the 25,942 shares transferred to the Trust Fund are concerned, the Fund being a separate entity.

3. If the answers to questions 1 and 2 are yes, was there a profit "realized"?

4. And if so, does it properly include dividends on

stock not owned by petitioner and not received by it, or, in fact, dividends on any stock at all?

5. Is the application of Section 16(b) by the Eighth Circuit so as to include dividends not received by the petitioner a violation of constitutional safeguard?

6. Is interest properly chargeable against any part of any judgment against petitioner in this matter?

STATUTES INVOLVED

Section 16(b) of the Securities Exchange Act of 1934, *15 U.S.C.A.* 78 p(b) provides as follows:

> "For the purpose of preventing the unfair use of information which may have been obtained by such beneficial owner, director, or officer by reason of his relationship to the issuer, any profit realized by him from any purchase and sale, or any sale and purchase, of any equity security of such issuer (other than an exempted security) within any period of less than six months, unless such security was acquired in good faith in connection with a debt previously contracted, shall inure to and be recoverable by the issuer, irrespective of any intention on the part of such beneficial owner, director, or officer in entering into such transaction of holding the security purchased or of not repurchasing the security sold for a period exceeding six months. Suit to recover such profit may be instituted at law or in equity in any court of competent jurisdiction by the issuer, or by the owner of any security of the issuer in the name and in behalf of the issuer if the issuer shall fail or refuse to bring such suit within sixty days after request or shall fail diligently to prosecute the same thereafter; but no such suit shall be brought more than two years after the date such profit was realized. This subsection shall

not be construed to cover any transaction where such beneficial owner was not such both at the time of the purchase and sale, or the sale and purchase, of the security involved, or any transaction or transactions which the Commission by rules and regulations may exempt as not comprehended within the purpose of this subsection."

STATEMENT

As of January 1, 1960, the petitioner, Gamble-Skogmo, Inc., defendant below, was the beneficial owner of more than 10% (1,256,044 shares) of common stock issued by Western Auto Supply Company, a former Missouri corporation, hereinafter called "Western Missouri". Prior to January 15, 1960, there was due and owing from Gamble-Skogmo to its employees' Profit Sharing-Stock Bonus Trust Fund an unliquidated obligation subsequently determined to be the sum of $839,251.78. On January 15, 1960, the Gamble-Skogmo Executive Committee approved the purchase of 32,000 shares of Western Missouri common stock for the purpose of contributing them, or as much thereof as would be necessary, to the Trust Fund in order to satisfy Gamble-Skogmo's 1959 obligation, the exact amount of which was then unknown. The selection of the number of shares of such stock to be purchased January 15, 1960, viz., 32,000 shares, was based upon the best estimate then available as to the largest number of such shares which it was believed might be necessary to satisfy Gamble-Skogmo's obligation.

On January 21, 1960, Gamble-Skogmo actually purchased this 32,000 shares of Western Missouri common stock at $32.35 per share through Allen and Company, an investment securities dealer. On January 27, 1960,

Allen and Company delivered to Gamble-Skogmo the required number of share certificates of Western Missouri bearing street names (not designated by Gamble-Skogmo) and endorsed in blank. Immediately upon receipt of the stock, on January 28, 1960, Gamble-Skogmo caused 25,942 shares of this stock to be transferred to the Trust Fund, with a check for $28.08 to make up the required $839,251.78 in pursuance of its plan of contribution. The specific dollar amount to be contributed by Gamble-Skogmo to the Trust Fund was determined about January 28, 1960, and in any event subsequent to January 21, 1960. The remaining 6,058 shares of the 32,000 shares of Western Missouri thus purchased were then transferred to Gamble-Skogmo on the stock records of Western Missouri bringing its total ownership to 1,262,102. All of these shares were sold to the Beneficial Finance Co. on July 11, 1960, for a price of $36.00 per share.

In the interim from the date of receipt of the 6,058 shares to July 11, 1960, Gamble-Skogmo had received dividends on its Western Missouri stock totaling 70 cents per share. And the Trust Fund received dividends on its 25,942 shares in the same amount.

On July 28, 1961, Beneficial and Western Missouri agreed to merge into Beneficial. The merger was completed on October 27, 1961. On the same date, Beneficial sold all its Western Missouri assets to Western Auto Supply Company, a Delaware corporation, hereinafter referred to as "Western Delaware".

In December of 1961 pursuant to a request from the President of Western Delaware demanding an accounting of the profits realized on the 32,000 shares which Gamble-Skogmo had acquired for transfer and for the dividends

paid thereon, Gamble-Skogmo paid Western Delaware $22,111.70, the difference between the price it received and the price paid for the 6,058 shares of Western Missouri retained by it, but refused to make any payment on the 25,942 shares which it had delivered to the Trust Fund. It is admitted that these shares were contributed to the Trust Fund at the exact cost of $32.35 per share, which with its check for $28.08 made the exact contribution which Gamble-Skogmo was required to make to the Trust Fund under the formula in the Trust Agreement.

No payment was made on the dividends received by Gamble-Skogmo on the 6,058 shares, and no payment was made on dividends received by the Trust Fund on its 25,942 shares.

At the date of sale to Beneficial by Gamble-Skogmo, a Civil Anti-trust Action 12776 (commenced April 1, 1960) was pending in the United States District Court for the Western District of Missouri, Western Division in which the United States was seeking to require the divestiture by Gamble-Skogmo of its then holdings of Western Missouri. During the course of this antitrust litigation, the petitioner, with a view to disposing of that matter, had made several attempts to dispose of its holdings in Western Missouri. Immediately following the sale to Beneficial, which sale was discussed with the Department of Justice by the intervenor and the defendant prior to its consummation, on July 18, 1960, the antitrust action in the Western District of Missouri was terminated by a Consent Decree which recognized the sale to Beneficial and in substance enjoined the defendant from owning shares of Western Missouri in the future.

But for the actions of the United States of America in

the Civil Action above referred to, no disposition of Western Missouri shares by the defendant would have been undertaken or consummated during the six months period commencing January 21, 1960. The defendant had no plans for disposing or attempting to dispose of these shares prior to the action of the United States government referred to herein.

Prior to the entry of the Consent Decree July 18, 1960, Gamble-Skogmo was under no obligation from the courts to dispose of its Western Missouri common stock within the six months period commencing January 21, 1960, but it was under a preliminary injunction restricting the persons to whom it could sell Western Missouri stock during this period. At no time did Gamble-Skogmo admit the claims upon which the government was basing its complaint.

The District Court of Minnesota also found as facts that the 25,942 shares which passed into the holdings of the Trust Fund were simply handled by Gamble-Skogmo as a conduit for the purpose of enabling the Trust Fund to place among its assets this number of shares; that the Trust Fund was not the alter ego of Gamble-Skogmo; and that this transfer was not an example of short swing trading. Also it found that there is absolutely no danger that a matching of stock certificates in this case will allow a circumvention of the Act.

The jurisdiction of the Federal Court in the first instance was invoked pursuant to the provisions of the Securities and Exchange Act of 1934, *15 U.S.C.A.*, Section 78 aa, to interpret the provisions of Section 78 p(b) of that Act.

REASONS FOR GRANTING WRIT

This matter involves important questions of interpretation of Section 16(b) of the Securities Exchange Act of 1934. The office of the General Counsel of the Securities and Exchange Commission has advised us that because it agrees with the decision below on the merits, it is not in a position to support our request for the grant of certiorari. On the other hand, the office of the General Counsel has informed us that it has no objection to our stating to the court that in its view this case does in fact involve important areas in the administration of the Securities laws in which the Supreme Court has not previously spoken.

(a) The Eighth Circuit Decision Conflicts With General Principles Of Statutory Interpretation Set Forth By The Supreme Court.

The decision of the Eighth Circuit Court in the present case is a triumph of form over substance in the interpretation of a Federal Statute.

Judge Nordbye in the District Court of Minnesota supported by Judge Van Oosterhout of the Eighth Circuit, found as a fact (R. p. 173) that the 25,942 shares which passed into the holdings of the Trust Fund were simply handled by Gamble-Skogmo *as a conduit* for the purpose of placing these shares in the Trust; that this was not an example of short swing trading, that there was absolutely no danger that a matching of certificates would allow a circumvention of the Act (R. p. 173) and states (R. p. 173):

> "Under the circumstances here, the Court is not required to adopt some fiction in order to put teeth into the law."

The Securities and Exchange Commission in its amicus curiae brief in the Circuit Court disagreed with Judge Nordbye on the facts, but agreed that if his finding of fact concerning a conduit was correct, so was his conclusion (Appendix A, p. A-18).

> "Judge Nordbye's conclusion that appellee acted as a 'conduit' for the purpose of making the purchase for the Trust Fund appears to be without support in the record. * * * If, however, appellee had, in fact, confined its activities in connection with the questioned transactions to acting solely as agent for the Trust Fund, the trial court's result might have been reached without endangering the principles which we feel must not be impaired."

In the light of the Supreme Court's comments in *Blau v. Lehman*, 368 U. S. 403, in which the Securities and Exchange Commission appeared, this use by the S.E.C. of the word "agent" cannot be considered as referring to an ordinary principal-agent relationship where the agent's implied inside knowledge of Western Auto's affairs would be controlled or governed by the Trust Fund.

The Eighth Circuit Court apparently adopts the foregoing findings which the dissenting opinion specifically points out are supported by substantial evidence (Appendix A). But having adopted them, it ignores them and in order to prevent Gamble-Skogmo from accomplishing a result which Gamble's own actions made impossible (i.e., "realizing a profit" from its fiduciary position) the court chooses a very narrow and technical interpretation of Section 16(b) based apparently upon the law of sales. In so doing, in effect, it overrules or vitiates the findings of fact in the lower court and turns fact into fantasy.

And, incidentally, its insistence on narrow interpretations and definitions of key words of the statute can hardly be considered uniform, for while it carefully points out the alleged precise legal import of the words "purchase" and "sale" and their unchanging content, it is at considerable pains to point out (Appendix A, p. A-11) that "profit" under 16(b) does not in fact have a plain and ordinary meaning at all, despite the court's assertion elsewhere (Appendix A, p. A-10) that it does. In the particular paragraph of its opinion describing "profit", the court purports to rely upon a rule established in the case of *Smolowe v. Delendo Corp.*, 136 F. 2d 231, to fit a particular situation, without apparent realization that neither facts giving rise to the rule nor the reason for its existence are here present.

This action and technical interpretation of 16(b) by the Eighth Circuit is at variance with the instructions of the Supreme Court on interpreting Federal Statutes of a remedial or regulatory nature. In *United Gas Improvement Co. v. Continental Oil Co.*, 85 S. Ct. 1517, involving the Natural Gas Act the Supreme Court has recently spoken on this matter, in a case in which a definition of the word "sale" was passed upon.

> "A regulatory statute such as the Natural Gas Act would be hamstrung if it were tied down to technical concepts of local law. The Court recognized as much in National Labor Relations Board v. Hearst Publications, Inc., 322 U. S. 111, 64 S. Ct. 851, 88 L. Ed. 1170, when it held that 'employee' as used in the National Labor Relations Act was to be defined by reference 'to the purpose of the Act and the facts involved in the economic relationship' (id., at 129, 64 S. Ct., at 860) rather than exclusively by reference to common law standards or local law."

An Act such as Section 16(b) is admittedly remedial, broadly remedial, and even referred to as "involving a prophylactic" effect, *Blau v. Lehman*, 368 U. S. 403. As a matter of public policy the purpose of an Act and the facts involved in the economic relationships in an individual case must determine its application.

If this rule were not so, Federal Statutes and their objectives would be subject not merely to technical and varying common and local law concepts, but to the ingenuity of those persons who could circumvent the substantive purpose of the Act, and by various ingenious legal forms produce the same prohibited result. Clearly far more defendants would escape Congressional prohibitions, than would come under them, if the art of the legislative draftsman were an invitation to a mere change of form, to circumvent the purpose of the law.

But since the established rule of law makes the purpose of the statute control the application, this petitioner is entitled to have the benefit of the rule. To use a different criterion, one of technical interpretation, merely because the established rule does not produce a result felt to be desirable, is manifestly unjust.

(b) Treatment Of Problem By Other Circuits.

In any Circuit except the Eighth Circuit, Gamble-Skogmo would have had the benefit of the application of 16(b) exactly in conformity with the rule laid down by the Supreme Court. The Second, Sixth and Ninth Circuits all reject holding that the words of 16(b) are literal whether "purchase", "sale", "profit realized", or others, or that they have a plain ordinary meaning, or are of precise legal import.

As stated in *Blau v. Lehman*, 286 F. 2d 786 (affirmed 368 U. S. 406) in the Second Circuit by Judge Medina:

> "But the underlying principle, as I understand it is that the transaction is a purchase if in any way it lends itself to the accomplishment of what the statute is designed to prevent. * * * *There is no rule of thumb, nor would it be wise to attempt to formulate such a rule*" (Italics supplied).

This principle is followed in the Courts of that Circuit up to and including *Blau v. Lamb* (S.D.N.Y. May, 1965), 292 F. Supp. 151, in which the Court stated:

> "The test (e.g. as to the meaning of the words) succinctly stated is whether or not the transaction lends itself to the accomplishment of what the statute is designed to prevent."

The Sixth Circuit has specifically adopted the rule of the Second Circuit. *Ferraiolo v. Newman*, 259 F. 2d 342.

> "The standard that emerges from these decisions can be simply stated: Every transaction which can reasonbly be defined as a purchase will be so defined *if the transaction is of a kind which can possibly lend itself* to the speculation encompassed by Section 16(b)" (Italics supplied).

The Ninth Circuit uses the same test. *Blau v. Max Factor & Co.*, 342 F. 2d 304 (1965) (306-07).

> "A transaction is held to be a purchase if in any way it lends itself to the accomplishment of what the statute is designed to prevent. * * * *On the other hand to avoid purposeless harshness*, a transaction is held not to be a section 16(b) purchase if it was not one that could have lent itself to the practices which 16(b) was enacted to prevent" (Italics supplied).

There can be no doubt that if the Eighth Circuit continues to apply 16(b) in the manner and spirit it did in this case, as contrasted to the spirit manifested in other circuits and the rules followed in them, the geographical location of any future defendants is going to have a tremendous impact upon their potential liability. And we respectfully suggest that Gamble-Skogmo's geographical location has had just such an impact here. Uncertainty will prevail and a definite criterion for judging actions even in the Eighth Circuit will be non-existent, where the precise legal meanings and even the plain and ordinary meanings of "sale", "purchase" and "profit" may differ from state to state, and where even the very situs of an action can determine the law of the state which applies.

(c) Principles of Blau v. Lehman, 368 U. S. 403.

In the case of *Blau v. Lehman,* this Court ruled the "prophylactic" effect Congress clearly prescribed could not be added to by attributing to an insider profits from transactions realized by parties who were not insiders.

> "It would be nothing but a fiction to say that Thomas 'realized' all of the profits earned by a partnership of which he was a member. It was not error to refuse to hold Thomas liable for profits he did not make."
>
> *Blau v. Lehman,* 368 U. S. 403, p. 415.

And it further held that "short swing profits" realized by outsiders acting on the basis of inside information or having the possibility of inside information, cannot be recovered from either an insider or an outsider, at least in the absence of showing that the insider is the alter ego or deputy of the outsider in his relationship to the issuer.

But in reaching the conclusion it did, the Circuit Court in this instance is unquestionably seeking to make Gamble-Skogmo disgorge benefits or profits which were in fact received by the Trust Fund, and to do so it adopts the fiction that what was not in fact a trading operation or profit making opportunity by Gamble-Skogmo by any stretch of the imagination, was in legal effect some mysterious form of short swing trading activity. Whatever evil may be involved or imagined in connection with an insider contributing to the assets of a company profit-sharing trust fund, shares of stock which it feels will be beneficial to the fund, it is inconceivable that such evil was one of the abuses whose cure is clearly prescribed by Congress as part of the "prophylactic" effect of Section 16(b). The acquisition for transfer and transfer of the 25,942 shares was not a trading activity by Gamble-Skogmo at all.

Just as certainly as the petitioners in the *Blau* case were seeking to charge Thomas for all profits made by a third party (Lehman), the plaintiffs in this action are seeking to recover profits from Gamble-Skogmo made or available to the Trust Fund, although here, unlike the *Blau* case, Gamble-Skogmo had no interest in the Fund at all. And the Eighth Circuit in reversing the District Court, has failed to follow the principles laid down by the Supreme Court in rejecting such an attempt in the *Blau* case. Clearly under the *Blau* case Gamble-Skogmo could have transferred cash to the Fund, given it inside information if it had any, and the Fund then acquired the 25,942 shares. But the Eighth Circuit seems to be saying that although this result can be arrived at indirectly with just as much effect or lack of effect upon outside shareholders or the public generally, the technical language of the Act precludes a direct acquisition

and contribution. The Supreme Court does not permit the alleged prophylactic effect attributed to Congress to be used as a grounds to charge Thomas with $95,000 he did not receive, and never could have received, under the asserted claim it was "profits realized". The Eighth Circuit uses the guise of maintaining the same prophylactic effect as a reason for charging Gamble-Skogmo with $100,000 it did not receive and never could have received, stating that the money constituted "profits realized".

DIVIDENDS

As to the award of dividends made by the majority of the Court of Appeals, the law seems to be completely unsettled. Prior to Judge Nordbye's decision in the Minnesota District Court awarding dividends on the 6,058 shares held by Gamble-Skogmo and not transferred, no case is known in which dividends were ever held to constitute "profits realized" and only one case, *Adler v. Klawans*, 267 F. 2d 840, appears to have discussed such a possibility. And yet in the majority of transactions in which 16 (b) is sought to be invoked, the question is bound to occur, because by far the majority of "issuers" do pay at least one dividend in any given six months period. So that the matter is important and some definitive guide lines are needed.

Brief consideration will show that confusion rather than clarity will result from any attempt to consider dividends a part of "profits realized". For instance, suppose a sale of stock under 16(b) followed by a purchase within six months at a lower price. Are the dividends paid to third parties on the stock during the period between the sale and the purchase "profit realized" on the grounds that the

sale and purchase can be "matched" for 16(b) purposes? Evidently the Eighth Circuit thinks so, for it has matched what it considers to be a "sale" and a "purchase" and blithely attached to this artificially constructed transaction dividends on 25,942 shares which were paid, not to the Fiduciary but to the Trust Fund.

The statute speaks of profit from purchase and sale. Ordinarily dividends would not be considered as profit "derived from" a purchase and sale, or trading activity. And the Eighth Circuit states that it believes the plain ordinary meaning of words of precise legal import is to govern. The Second Circuit in discussing the problem of dividends in *Adler v. Klawans,* 267 F. 2d 840, follows the pragmatic approach shown in its decisions on other phases of 16(b), and refusing to grant recovery for dividends suggests the following rule:

> "Situations may well arise relative to dividends where they are so inextricably connected with the 'purchase' and 'sale' of stock and possible manipulation by the insider for their own benefit and to the detriment of the corporation and the investing public as to compel the formulation of a rule on the subject under discussion in order to prevent the frustration of the statutory purpose described in the main part of this opinion."

Judge Nordbye in the Minnesota District Court was apparently the second judge to pass upon the question of dividends. He was the first judge to include them, holding (we believe erroneously) that the dividends on the 6,058 shares held by Gamble-Skogmo could be recovered under the reasoning of the *Adler* case, without specifying what facts he believed made that case applicable or what he believed the reasoning of the *Adler* case might be. And since the opin-

ion of Judge Nordbye two other cases, *Blau v. Lamb*, 242 F. Supp. 151, and *Marquette Cement Mfg. Co. v. Andreas*, 239 F. Supp. 962, have been decided. Both were in the District Court for the Southern District of New York. One case (*Blau v. Lamb, supra*) held one dividend recoverable and another not, because:

> "As to the June 30 cash dividend, I regard it as too incidental and not 'so inextricably connected' with defendant's purchase-and-sale transactions to be included in the amount recoverable. See Adler v. Klawans, 267 F. 2d 840, 849 (2d Cir. 1959). While it may be argued that, because the June 30, 1955 dividend was apparently the highest ever paid by Air-Way, it may have been part and parcel of an overall scheme of short-swing speculation, on balance, I am unpersuaded that such was the case. *Air-Way had been paying regular quarterly dividends at least since June, 1954*—before that date the record is silent—and declared dividends had fluctuated, a not unusual phenomenon in other companies depending upon usual criteria such as earnings, the state of the industry, management forecasts and the like" (Italics supplied).

The other case (*Marquette v. Andreas*) applying what appears to be a different view of the law held dividends recoverable. So that the state of the law is unsettled. This condition of uncertainty should not be permitted to continue in an area of such importance to the business community and investing public. Because the rules of 16(b) are always harsh, they at least should be definite and clear.

Whatever may be said or decided, however, about the question of dividends received by an "insider", the action of the Eighth Circuit in awarding judgment for dividends on 25,942 shares which the Trust Fund received raises a

far different problem. The majority again rejects the pragmatic approach to Section 16(b), and may fairly be said to treat the *Adler* case as establishing exceptions to some general rule which the court does not describe. By piling the fantasy of these dividends upon the fiction of a purchase and sale under 16(b), the court has reached a point where constitutional problems of due process exist. The application of 16(b) by the Eighth Circuit, at least to the problem of dividends, seems not only fundamentally unjust, but to be lacking in any rational and reasonable relationship to attaining the ends desired by Congress. The means of enforcing the law adopted by this Circuit go so far beyond any necessities of the case as to make the statute as construed an arbitrary exercise of government power.

CONCLUSION

Except to the extent contained in the opinion in *Blau v. Lehman*, 368 U. S. 403, the Supreme Court has never passed upon the application and meaning of 16(b). Originally such interpretation was probably not warranted. The number of cases arising under it was small and the fact situations were relatively simple. But litigation is increasing under it (at least five cases reported in the last six months, including this one, and in three different circuits) and the fact situations are becoming more complex. Moreover with the passage by Congress of the Securities Acts Amendments of 1964 (Public Law No. 88-467) the necessity of a clear and consistent rule in applying the section takes on a new dimension. The section will ultimately become applicable to every issuer engaged in interstate commerce, or whose securities are traded by the use of the mails or means of interstate commerce, having total assets in

excess of $1,000,000 and a class of equity securities held of record by 500 or more persons, so that a clear solution to these problems is definitely needed.

For the foregoing reasons it is respectfully submitted that this petition for a writ of certiorari should be granted.

Respectfully submitted,

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